



Treasury Inspector General for Tax Administration

MORE COMPLETE AND ACCURATE DATA ARE NEEDED TO ASSESS THE IMPACT OF ACTIONS TO ADDRESS COMPLIANCE REPORTING OF STATE AND LOCAL GOVERNMENT ENTITIES

Issued on June 8, 2007

Highlights

Highlights of Report Number: 2007-10-081 to the Internal Revenue Service Commissioner for the Tax-Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

Payments by Federal, State, and Local Governments office (hereafter referred to as the FSLG office or the Office) customers represent a large part of the national economy. Annually, Federal, State, and local governments purchase goods and services of more than \$2.5 trillion that potentially affect information return and backup withholding requirements. Because of the potential volume and dollar amount of the information returns issued by governments, any omissions could affect the tax gap if the income paid by governments is not reported to the Internal Revenue Service and reflected on the individuals' tax returns. In addition to the immediate compliance concern, this noncompliance threatens the perceptions of fairness and accountability that are at the foundation of the voluntary tax compliance system.

WHY TIGTA DID THE AUDIT

This audit was conducted as part of TIGTA's Fiscal Year 2007 Annual Audit Plan. A December 2003 Government Accountability Office review of Federal Government agencies found significant compliance issues involving information return filing and backup withholding. Due to the prior attention to the compliance reporting of Federal Government agencies by the Government Accountability Office, our review focused on information return filing and backup withholding compliance by State and local governments.

WHAT TIGTA FOUND

The FSLG office is taking some actions to address State and local governments' information return filing and backup withholding requirements, including performing research during the case selection process to identify potential noncompliance in these areas and combining focused outreach efforts and the development of new educational products in Fiscal Years 2005 and 2006. Although the Office has made progress in this area, its database contained inaccurate and incomplete information related to case disposition and productivity in 21 (30 percent) of 71 cases TIGTA reviewed. As a result, TIGTA could not determine the overall impact of actions taken by the FSLG office to improve State and local governments' compliance with information return filing and backup withholding requirements. Continued emphasis by the FSLG office in this area and more accurate information related to its compliance check and examination efforts will provide assurance that Office customers file all necessary information returns and tax revenue is accurately reported as required.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Director, FSLG, (1) reemphasize and update existing guidelines for the case selection survey sheet used to track the disposition and productivity of closed compliance contacts, (2) update the FSLG office's database with the compliance information on the large non-Federal Government entity examinations closed in Fiscal Years 2005 and 2006 and ensure future initiatives are tracked on the database, and (3) review our analyses of State and local government entities' information return filings for Tax Years 2003 – 2005 to determine if potential compliance activities are warranted and if revisions to the current classification process are necessary to better identify potential nonfilers.

In their response to the report, Internal Revenue Service officials agreed with our recommendations and are planning to take adequate corrective actions.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full Internal Revenue Service response, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200710081fr.pdf>.